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No. 79-1523

In the Supreme Court of the United States

OCTOBER TERM, 1979

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-72a) is reported at 606 F.2d 1094. The orders of the Federal Energy Regulatory Commission[1] (Pet. App. 77a-130a) are not yet reported.

[1] Under Section 402(a)(1)(C), (D), (E), and (F) of the Department of Energy Organization Act, Pub. L. No. 95-91, 91 Stat. 583, 42 U.S.C. (Supp. II) 7172(a)(1)(C), (D), (E), and (F), this agency has succeeded to the relevant functions and responsibilities of the former Federal Power Commission with respect to the certification and regulation of sales of nat-

JURISDICTION

The judgment of the court of appeals was entered on June 20, 1979. A petition for rehearing was denied on October 31, 1979 (Pet. App. 73a-76a). On January 17, 1980, the Chief Justice extended the time for filing a petition for a writ of certiorari to and including March 29, 1980; the petition was filed on March 28, 1980. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether the Commission properly exercised its discretion in holding that a pipeline is not entitled to include in its rate base—and recover the costs of—expenditures for unsuccessful alternate gas supply projects, when such expenditures were not "used and useful" in providing service to jurisdictional ratepayers.

STATUTE INVOLVED

Section 4(a) and (e) of the Natural Gas Act, 15 U.S.C. 717c(a) and (e), are set forth at Pet. App. 131a-132a.

STATEMENT

In July 1974, Transcontinental Gas Pipe Line Corporation (Transco) filed a general rate increase pursuant to Section 4 of the Natural Gas Act, 15 U.S.C.

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ural gas in interstate commerce under the Natural Gas Act, 15 U.S.C. 717-717w. The term "Commission" herein refers to the Federal Power Commission or the Federal Energy Regulatory Commission as the context indicates.

717c, seeking return on, and recovery of, over $22 million it had expended on four unsuccessful projects relating to the production of synthetic natural gas (SNG).[2] Transco proposed to include these expenditures in its rate base and thereby earn a return on them; it sought also to recover the full costs of the unsuccessful projects by including them as expense items in its cost of service, amortizing them over a five-year period (Pet. App. 79a, 80a-81a).

The Commission affirmed the administrative law judge's refusal to grant Transco this rate treatment (Pet. App. 77a-108a).[3] In so ruling, the Commission rejected Transco's argument that because the expenditures were prudent investments, they must necessarily be included within its rate base and in its costs of service (Pet. App. 82a-87a). As the Commission elaborated on rehearing (Pet. App. 121a):

> [E]ven if these SNG project expenditures are assumed to be prudent, rate base inclusion or even Transco's settlement proposal of only cost of service amortization is not necessarily mandated. Part and parcel of the "prudent investment" theory is the "used and useful" requirement; that is, only prudent investment for utility

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[2] Transco had abandoned the projects before completion for a variety of reasons (see Pet. App. 80a-81a n.1).

[3] The Commission also rejected Transco's offer of settlement under which it would have been permitted to amortize the costs of three of the four unsuccessful projects by including them in rates but would forego earning a return on the expenditures by excluding the project costs from rate base (Pet. App. 85a-87a, 123a-124a). The court of appeals affirmed the Commission's ruling (see Pet. App. 62a).

> property which is used and useful to provide service to the utility's customers should be compensated. To say the least, the "used and useful" criterion should not take Transco by surprise, and it would be disingenuous to argue that the SNG studies and coal options for abandoned projects involved herein are "used and useful."

The Commission also concluded that Transco's four projects did not constitute research and development (Pet. App. 83a), and adhered to its firm policy "that SNG expenditures which do not qualify as [research and development] can be recovered, if at all, only through the price paid for actual SNG production sold in interstate commerce" (*id.* at 123a).

The court of appeals affirmed (Pet. App. 1a-72a). It found that the Commission's ruling that the pipeline's ratepayers should not be charged with expenditures that were not "used or useful" in providing service "clearly was a proper exercise of discretion" in the circumstances of this case (Pet. App. 61a).[4]

ARGUMENT

In affirming the Commission's ruling, the court of appeals relied on the doctrine that "for rate base inclusion expenditures must satisfy not only the necessary condition of prudent investment but also must be 'used and useful' in providing service"

[4] On March 3, 1980, this Court denied a petition for a writ of certiorari regarding the separate advance payments issue decided by the court of appeals in this case. *Tennessee Gas Pipeline Co.* v. *FERC*, No. 79-962.

(Pet. App. 62a). Petitioner has submitted no grounds warranting review of that decision by this Court.

1. Petitioner's principal claim (Pet. 10) is "that the used and useful concept is inconsistent with the Commission's prudent investment standard for cost recovery, and when the concepts are applied as a dual test, confiscation of property devoted to public service results." This claim does not withstand analysis.

In *FERC* v. *Pennzoil Producing Co.*, 439 U.S. 508 (1979), this Court recently reaffirmed the well-established proposition that the Commission has wide discretion to determine just and reasonable rates. The Commission's ratemaking authority is not limited simply to deciding whether the "cost[] is not imprudent * * *." *Id.* at 517. On the contrary, the settled rule is that so long as the rate adopted by the Commission is "within a 'zone of reasonableness,'" the " 'courts are without authority to set [it] aside.' " *Ibid.*, quoting *Permian Basin Area Rate Cases*, 390 U.S. 747, 797 (1968).

The "zone of reasonableness" test was clearly satisfied in this case. As the court of appeals correctly observed, it is a "well-rooted regulatory principle" (Pet. App. 31a) that "rate base inclusion expenditures must satisfy not only the necessary condition of prudent investment but also must be 'used and useful' " (Pet. App. 62a).[5] The court below properly

[5] In this regard, the court of appeals referred (Pet. App. 29a) to this Court's decision in *Smyth* v. *Ames*, 169 U.S. 466, 546 (1898), as "articulat[ing] th[is] guiding principle." The

concluded that "[s]ince the projects did not produce any jurisdictional gas" (*id.* at 61a), the Commission's rejection of Transco's rate filing was amply supported under "traditional principles" (*id.* at 31a).[6]

2. Petitioner errs in contending (Pet. 5, 6, 13) that the ruling below is inconsistent with judicial and Commission precedents.

a. In *Tennessee Gas Pipeline Co.* v. *FPC*, 487 F.2d 1189 (D.C. Cir. 1973), the District of Columbia Circuit affirmed the Commission's denial of a pipeline's request for recovery of expenditures on an unsuccessful liquid natural gas (LNG) facility, recognizing that prudency alone is not the sole test for cost re-

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court below explained (Pet. App. 29a-30a; footnotes omitted; emphasis supplied by the court):

> In *Smyth* v. *Ames*, the Supreme Court articulated the guiding principle that "the basis of all calculations as to the reasonableness of rates to be charged by a [public utility] must be the fair value of the property *being used by it for the convenience of the public.*" Although methods for determining values of rate base items have evolved since *Smyth* v. *Ames*, the precept endures that an item may be included in a rate base only when it is "used and useful" in providing service. In other words, current rate payers should bear only legitimate costs of providing service to them. The FPC early adopted the "used and useful" standard and has not departed from it without careful consideration of the wisdom of requiring current rate payers to bear costs of providing future service.

[6] Petitioner suggests (Pet. 5) that the court's opinion afforded insufficient attention to this issue. On the contrary, the fact that the court was able to dispose of Transco's objections to the Commission's denial in a few concise paragraphs underscores the well-established nature of the "used and useful" principle.

imbursement. In that case, the Commission, at the outset, had conditioned its grant of Tennessee's certificate application for construction of the LNG facility to preclude cost recovery in rates if the project ultimately proved to be unsuccessful. The Commission's attention to the "used and useful" principle in imposing that condition is apparent in its underlying opinion. See *Tennessee Gas Pipeline Co.*, 48 F.P.C. 149, 156 (1972); see also the affirming opinion of the court of appeals, 487 F.2d at 1196-1197.

Again, in *Tennessee Gas Pipeline Co.* v. *FPC*, 561 F.2d 955 (D.C. Cir. 1977), the court of appeals affirmed the Commission's elimination of construction overhead costs as a current expense, finding that "these costs are not incurred for the benefit of *present* consumers" (561 F.2d at 958), and concluding that the Commission had properly relied on the "long-established ratemaking policy of charging construction costs only to those consumers who benefit from the new service. This policy rests upon the 'used and useful' test * * *." 561 F.2d at 957. Finally, in *Transcontinental Gas Pipe Line Corp.* v. *FPC*, 518 F.2d 459 (D.C. Cir. 1975), Transco's attempts to include nonrecoverable advance payments in its rate base were rejected. In that case, the court of appeals affirmed the Commission's ruling denying Transco a return on "working capital dedicated to advance payments which, though prudently made, have become unrecoverable." 518 F.2d at 465.

While prudence is indeed a necessary condition to inclusion of expenditures in rate base, the above cases

demonstrate that the "used and useful" test must also be satisfied before jurisdictional ratepayers, rather than shareholders, become obliged to bear the pipeline's business losses.[7]

b. Nor is there a conflict between the panel's decision in this case and another panel's earlier determination in *Washington Gas Light Co.* v. *Baker*, 188 F.2d 11 (D.C. Cir. 1950), cert. denied, 340 U.S. 952 (1951).[8]

The *Baker* decision concerned the choice of permissible (not mandatory) ratemaking policy by an independent local regulatory body—the District of Columbia Public Utilities Commission. In *Baker* the court expressly noted that "the composition of the rate base falls within the province of the Commission under the doctrine of the *Hope* case" [*FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944)]. 188 F.2d at 18. The court interpreted *Hope* as holding that "the Commission may adopt any method of valuation for rate base purposes so long as the end result of the rate order 'cannot be said to be unjust and unreasonable.' " *Ibid.*, quoting from *FPC* v. *Hope Natural Gas Co.*, *supra*, 320 U.S. at 602. This standard

[7] Moreover, the court below correctly observed (Pet. App. 61a n.115) that the Commission's Uniform System of Accounts, 18 C.F.R. Part 201 (originally promulgated in 1939 (4 Fed. Reg. 4764)), provided "clear notice" that the planning costs of abandoned projects contemplated to provide future gas supply would in certain cases be absorbed by pipeline investors, not recovered through rates.

[8] Even if such a conflict did exist it is "primarily the task of a Court of Appeals to reconcile its internal difficulties," not the task of this Court. *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957).

is in accord with the settled rule as regards the ratemaking policies of the Commission. See, *e.g.*, *FERC* v. *Pennzoil Producing Co.*, *supra*.

Indeed, *Baker* itself demonstrates that the test of prudency is not the sole consideration governing rate base inclusion; the court emphasized that "inclusion in the rate base must meet the test of justness and reasonableness to the consumer, as well as to the investor." 188 F.2d at 19. In any event, subsequent to its decision in *Baker*, the District of Columbia Circuit noted that the so-called "prudent investment" theory does not control rate base formulation under the Natural Gas Act, even though it has been used in local utility regulation in the District of Columbia.[9]

c. Petitioner is also in error in asserting (Pet. 13) that the Commission has a general policy which permits electric utilities to recover expenditures on failed power supply projects. Petitioner refers to the cases of two electric utilities, New England Power Company and Southern California Edison Company, in which the Commission permitted recovery of the costs of specific unsuccessful power supply projects but not inclusion of such costs in rate base. In each instance, the Commission explained the special circumstances in which the costs of the projects were

[9] *Democratic Central Committee of D.C.* v. *Washington Metropolitan Area Transit Comm'n*, 485 F.2d 786, 801-802 (D.C. Cir. 1973), cert. denied, 415 U.S. 935 (1974).

recoverable from ratepayers.[10] These fact-bound cases provide no basis for review of the decision below.

3. In sum, to the extent that Transco is seeking to earn a return on expenditures on its unsuccessful gas supply projects by including such expenditures in its rate base, its request is clearly unwarranted and without precedent. Regardless of the method or theory selected for valuating the rate base—original cost or reproduction costs (see Pet. 12)—the principle remains that property must be in service for the benefit of the ratepayer before it is included in rate base, *i.e.*, before a return is earned thereon. The Commission has used the original cost method of rate base valuation for decades and has concurrently applied the used and useful principle for determining which items should be included in rate base. There is

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[10] In Opinion No. 62, *Southern California Edison Co.*, Docket No. ER76-205 (Aug. 22, 1979), the Commission ruled that Edison's loss on the abandoned Huntington Beach project was not atypical. Because such losses were likely to continue at a consistent level, the Commission concluded that they deserved recognition in Edison's rates as a recurring expense.

Similarly, in Opinion No. 821, *Southern California Edison Co.*, Docket No. E-8176 (Sept. 22, 1977), the Commission had earlier permitted the company to write off expenditures related to its abandoned projects that also were found to deserve treatment as recurring losses.

In Opinion No. 49, *New England Power Co.*, Docket Nos. ER76-304, *et al.* (July 19, 1979), the Commission affirmed the administrative law judge's ruling that the company should not be permitted to earn a return on its investment by including in its rate base expenditures on an abandoned electric generating unit. In that proceeding, all parties agreed, however, that the company should be permitted to recover the cost of the project.

no reason to require it to depart from that position in this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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